Supreme Court of the United States

October Term, 1974
No. A-1295

C. R. FEDRICK, INC., a corporation,
Petitioner,

vs.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,
Respondent.

RESPONDENT'S OPPOSING BRIEF

EVELLE J. YOUNGER,
Attorney General,
By PHILIP C. GRIFFIN,
Deputy Attorney General,
3580 Wilshire Boulevard,
Suite 800,
Los Angeles, Calif. 90010,
(213) 620-3175,
Attorneys for Respondent.

Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

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STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

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RESPONDENT'S OPPOSING BRIEF

The petitioner has petitioned this Honorable Court for a Writ of Certiorari to the California Court of Appeal, after decision in that court (*C. R. Fedrick, Inc. v. State Board of Equalization,* 38 Cal. App. 3d 385 (1974), Sup. Ct. hearing denied April 24, 1974). Essentially, petitioner has raised a dead issue which was decided by this Honorable Court in 1941 in the case of *Alabama v. King & Boozer,* 314 U.S. 1 (1941) which upheld state taxes on contractors doing business with the United States even as to cost-plus contracts where the terms of the contracts force their payment out of the federal treasury because the legal incidence of the tax is on the contractor, not the government. This is the exact factual situation presented in the petition. California taxes the sale of tangible personal property to contractors with the United States for use in the performance of contracts for the construction of improve-

ments on or to real property in California. Rev. & Tax. Code § 6384. The sales tax is imposed on the retailer who sells to the contractor. Rev. & Tax. Code § 6051. The retailer may collect reimbursement from the contractor if he chooses to do so and the contractor consents. Rev. & Tax. Code § 6052. If the contractor chooses to give a resale certificate instead of paying sales tax reimbursement and later uses the property in the performance of a contract with the United States for the improvement of real property in California he must pay use tax. Rev. & Tax. Code §§ 6094 and 6201. In this case, petitioner either gave resale certificates to its retailers or otherwise purchased its materials ex-tax and used the property in the performance of contracts to improve federal real property in California. The Board collected use tax and sought to collect [additional use tax] by way of counterclaim to the refund action of petitioner.

Petitioner relies upon an erroneous construction of the California Sales and Use Tax Law and cases that are inapposite to reach a conclusion that is totally unsound under both California and federal law. The California sales tax is a tax on retailers and does not fall upon the purchaser which in this case is the contractor for the federal government by reason of the fact that the retailer may reimburse himself only if he desires to do so under section 6052 of the Revenue and Taxation Code. In any event, only a contractor who made purchases as an agent of the United States government, which petitioner did not, would have any standing to assert any *constitutional* immunity of the federal government with respect to sales of supplies, materials and fixtures to the contractor. In enacting section 6384 of the Revenue and Taxation Code, the State of Califor-

nia did not go beyond the holding of the *Alabama v. King & Boozer* case. Section 6384 only acts upon the exemption provided by the Revenue and Taxation Code under section 6381 with respect to sales of tangible personal property to the United States and its instrumentalities and not upon federal immunity under the United States Constitution. Section 6384 treats United States contractors as consumers, that is, purchasers at retail so that the sales tax is imposed upon their suppliers as retailers. This is the settled law of California and no state or federal court has ever ruled to the contrary. Therefore, no authority supports the assertion by petitioner that section 6384 is unconstitutional under the supremacy clause of the constitution or violative of section 107 of Title 4 USC. Therefore no substantial federal question has been raised.

In an attempt to make it appear that there is a federal question petitioner complains that to tax the contractor for his purchase that he uses after giving a resale certificate somehow discriminates against the United States or contractors with whom it deals. In the first place, this issue was not properly raised in the state courts and was not even discussed by the court below. The issue is subject to the rule that this Honorable Court will not review questions not clearly raised on the record. *Standard Vacuum Oil Co. v. United States,* 339 U.S. 157, 160 (1949). In any event there is no discrimination against the United States nor against contractors with the United States. On the contrary, the purpose of section 6384 is to limit the tax exemption provisions in favor of the United States and its instrumentalities provided in section 6381 of the Revenue and Taxation Code. The result achieved is to tax the sale of tangible personal property to United States

contractors used in the improvement of California real property which would otherwise escape tax entirely under section 6381 of the Revenue and Taxation Code because contractors would give resale certificates and sell the property to the United States. Additionally, the tax imposed by reason of section 6384 on government contractors is generally not as great as that imposed on private contractors. The Board, in Regulation 1521, provides that contractors are retailers of tangible personal property that is accessory to a building when installed. The Board in Regulation 1615 has provided that all tangible personal property including accessory tangible personal property installed by government contractors is purchased by them for consumption in the performance of their government contracts and is therefore taxed on the basis of the purchase price paid for the tangible personal property and not the price charged to the federal government. Therefore, when it comes to property which is accessory to a building, government contractors pay less tax than private contractors. Hence there is no unconstitutional burden on the contractor dealing with the United States government but in fact favorable treatment of the government contractor.

Finally, petitioner asserts a federal question as to the applicability of the Buck Act in 4 USC sections 105 to 107. No substantial federal question is raised because the Buck Act does not interefere with the taxes imposed in this case in light of the decision in *Alabama v. King & Boozer, supra,* 314 U.S. 1 (1941). That portion of the decision of the Court of Appeal dealing with the provisions of the Buck Act though correct was unnecessary to the decision in the case in light of the *Alabama v. King & Boozer* case.

The District Court of Appeal held that section 6384 of the California Sales and Use Tax Law is constitutional relying upon *Alabama v. King & Boozer.* Petitioner's theories were rejected as meritless. It is respectfully submitted that the opinion of the Court of Appeal correctly disposes of the only constitutional issue treated in this case so that there is no necessity for a Writ of Certiorari in the United States Supreme Court. This is particularly true in light of the fact that this case has been reversed for a new trial because aside from the constitutional questions California law was misapplied by the trial court. There is absolutely no inconsistency between the opinion of the Court of Appeal and any other decision of California or the United States.

Questions as Presented by Petitioner.

1. Whether sections 6384 and 6007.5 of the Revenue and Taxation Code and sections 1615 and 1521 of Title 18 of the California Administrative Code as interpreted and applied by the California Court of Appeal below are unconstitutional as constituting an invidious discrimination against the federal government and those with whom it deals.

2. Whether said sections as so interpreted and applied are unconstitutional under the supremacy clause of the United States Constitution (Article VI, Clause 2) and section 107 of Title 4 USC.

3. Whether section 105 of the "Buck Act" (4 USC section 105) is wholly inapplicable to the facts of this case and whether this case is governed by section 107 of said Act (4 USC section 107).

ARGUMENT

I

Petitioner Is Precluded From Raising Constitutional Questions Not Properly Raised in the California Courts

It is apparent from the allegations in the complaint of petitioner in the California trial court (Petition for Certiorari, Appendix pp. 4 to 5) and the Conclusions of Law of the trial court in California (Petition for Certiorari, Appendix pp. 32 to 33) that no question as to the constitutionality of the Sales and Use Tax Law of the State of California was either an issue or decided by the California trial court. There was no pleading in the complaint that a claim for refund had been filed on any other grounds than those set forth in the complaint. On appeal the Court of Appeal raised a question as to the territorial taxing jurisdiction of the State of California in the following question:

> "Does the State of California have jurisdiction to exercise its taxing authority over transactions within such facilities if such facilities were acquired by the federal government pursuant to US Constitution, Article I, section 8, clause 17 or otherwise? That is to say, does Revenue and Taxation Code, section 6384, violate the sovereign authority of the federal government?"

The court dealt with that question under the preliminary discussion in its opinion (Petition for Certiorari, Appendix pp. 9 to 13). Also, the appellate court took note that in petitioner's supplemental brief on the question of territorial jurisdiction petitioner argued for the first time on appeal that section 6384 was unconstitutional because the ultimate "incidence" of the tax was

borne by the United States. The appellate court directed its attention to that question and distinguished the cases cited by petitioner (Petition for Certiorari, Appendix, pp. 13 to 15).

The procedure by which a taxpayer may bring suit in California to recover sales and use tax is governed solely by statute. Sections 6901 to 6902[1] require the filing of a claim for refund with the Board. The claim must be in writing and must state the *specific* grounds on which the claim is based. § 6904. Moreover, failure to properly file a claim with the Board within the time allowed by law constitutes a waiver of any demand against the state on account of the overpayment. § 6902. Only after this claim for refund is denied or not acted upon can the taxpayer bring a suit in the courts of California against the Board *upon the grounds set forth in the claim*. §§ 6932 and 6933. This procedure is jurisdictional in nature. *Abelleira v. District Court of Appeal*, 17 Cal. 2d 280, 293 (1941). In *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69 (1946), this Honorable Court unequivocally held that the claim for refund *frames and restricts* the issues for litigation, and must set forth the specific grounds upon which the claim is founded. To the same effect is *King v. State Board of Equalization*, 22 Cal. App. 3d 1006, 1015 (1972).

The Board strongly contends that, based upon the authority cited above, petitioner is limited to the legal issues as alleged and set forth in its complaint. Certainly, petitioner is limited to the questions in issue on appeal and not issues that were raised by supplemen-

[1]All references are to the California Revenue and Taxation Code.

tal brief for the first time on appeal. Beyond question petitioner is limited to questions that were specifically dealt with by the Court of Appeal. *Standard Vacuum Oil Co. v. United States*, 339 U.S. 157, 160 (1949). Therefore, the Board submits that in this petition the only legal issues that petitioner may raise are those specifically set forth as grounds in its complaint or properly raised on appeal. We respectfully submit that none of the questions presented by the Petition for a Writ of Certiorari were properly raised or considered by the Court of Appeal of the State of California and that therefore petitioner has not raised any substantial federal question for consideration by this Honorable Court.

II

Sections 6384 and 6007.5 of the California Revenue and Taxation Code and Sections 1521 and 1615 of the California Administrative Code Are Valid and Do Not Constitute an Invidious Discrimination Against the Federal Government and Its Contractors

Petitioner contends that sections 6384 and 6007.5 of the California Revenue and Taxation Code and Sections 1521 and 1615 of the California Administrative Code as interpreted and applied by the Court of Appeal below are unconstitutional as constituting an invidious discrimination against the federal government and those with whom it deals contrary to the rule in *Phillips Chemical Co. v. Dumas Independent School District*, 361 U.S. 376 and *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744. As we have pointed out, this issue was not properly raised in the Court of Appeal nor was it discussed in the opinion of the Court of Appeal. It was not raised in the claim for

refund or in the complaint in the trial court in California and was not decided by the trial court in California. Nevertheless, we will answer to the contention because it is clearly without merit. Section 6007.5 provides:

> "A sale of tangible personal property to a contractor or subcontractor for use in the performance of contracts with the United States for the construction of improvements on or to real property in this State *is a retail sale*. The gross receipts from such a sale or the sales price of property so sold shall be included in the measure of the taxes imposed by this part."

Section 6384 provides:

> "Notwithstanding any other provision of law the tax imposed under this part shall apply to the gross receipts from the sale of any tangible personal property to contractors purchasing such property either as the agents of the United States or for their account and subsequent resale to the United States for use in the performance of contracts with the United States for the construction of improvements on or to real property in this State."

Regulation 1615 provides:

> "United States Contractors. Either the sales tax or the use tax applies with respect to sales of tangible personal property (including materials, fixtures, supplies and equipment) to contractors or subcontractors for use in the performance of contracts with the United States for the construction of improvements on or to real property in this state. The fact that the contract may provide principally for the manufacture or acquisition of tan-

gible personal property is immaterial. The sales tax, *but not the use tax,* applies even though the contractor purchases the property as the agent of the United States.

"Tax does not apply to sales of 'machinery and equipment' to contractors or subcontractors." (Emphasis added.)

Regulation 1521 provides:

"Contractors are consumers of *materials* used by them in fulfilling construction contracts and the tax applies to the sale of such materials to the contractors.

"If, however, in the case of a time-and-material contract, the contractor bills his customer an amount for 'sales tax' computed upon his marked up billing for materials, it will be assumed, in the absence of convincing evidence to the contrary, that he regards himself as selling the materials so billed, and tax will apply to the amount of the billing for materials.

"Contractors are retailers of '*fixtures*' which they furnish and install and tax applies to the retail selling price thereof; which, in the case of lump sum construction contracts, is regarded as the cost price of the fixtures to the contractors. If the contractor is the manufacturer of the fixtures, the retail selling price thereof is the prevailing price at which similar fixtures in similar quantities ready for installation would be sold to contractors."

Generally "materials" are those materials which are used in constructing buildings, whereas "fixtures" are accessories to the buildings which are installed such as

lighting, plumbing, heating, air conditioning, refrigeration, elevator and other equipment for use in the operation of the building itself as distinguished from an activity within the building.

Petitioner argues that by Regulation 1521 and Regulation 1615, the Board discriminates in its application of the Sales and Use Tax Law in favor of construction contractors for the private sector of industry and against construction contractors for the United States. The Board does not discriminate between contractors and is merely following the statutory law of the State of California as set forth in section 6384 of the Sales and Use Tax Law.

Section 6384 is not designed to discriminate against the United States or its contractors. It is designed to define the limits of the *statutory* exemption granted to the United States by California. It does not have any bearing upon or relation to the United States *Constitutional* tax exemption of the United States government. A little history of the development of the statutes and the two regulations will demonstrate this point.

Following the enactment of the Retail Sales Tax Act, effective August 1, 1933, the original rule of the Board pertaining to contracts involving contractors was adopted by the Board in 1933 and designated as Ruling No. 11, Contractors and Subcontractors. Under the ruling, certain installation contractors were considered to be retailers rather than consumers of the equipment and components, and sales tax liability with respect thereto was measured by the fair retail price of the property exclusive of installation charges provided the charges were segregated in the records of the contractor. Otherwise, tax was payable on the full con-

tract price. The purpose of the regulation was to prevent the taxation of nontaxable installation services by distinguishing between contractors primarily selling services and those primarily selling tangible personal property.

There was no change in the ruling with respect to such installations until April 21, 1937, when the wording of Ruling 11 was revised, but the basic application of the tax was unchanged. The installer continued to be regarded as the retailer of equipment, taxable on its fair retail price if segregated in his records from the installation charges.

On March 23, 1939, amendments to Ruling 11 included the use, for the first time, of the terms "materials" and "fixtures." Each term was defined, along with an illustrative, but not exclusive, list of the kinds of property included in each category. The ruling provided that contractors were consumers of "materials" and retailers of "fixtures." The measure of tax, with respect to "materials," was stated to be the gross receipts from the sale of the "materials" to the contractor. The measure of tax with respect to "fixtures" was stated to be the "retail selling price" of the fixtures, which, in case the contractor "includes installation of fixtures in a contract, along with materials, labor, and other services, and, accordingly, does not invoice the selling price of the fixtures separately from the other items of the contract, the selling price of the fixtures shall be deemed to be the fair retail selling price of such fixtures, which shall not be less than the price of which similar fixtures, in similar quantities, would be sold to other contractors."

Subsequent amendments to Ruling 11 made no change in the application of the tax with respect to

"materials" or "fixtures," except in the case of contracts with the United States. An amendment effective June 11, 1941, added the following paragraph:

> "Contractors are the consumers of tangible personal property (including materials, supplies, fixtures, and equipment) used in the performance of contracts with the United States for the construction of improvement to real property, and the tax applies to the gross receipts from the sale of such tangible personal property to the contractors."

This amendment *was required* to conform the ruling to section 5.3 of the Retail Sales Tax Act of 1933 (later renumbered as Section 6384 of the Sales and Use Tax Law). This section became effective also June 11, 1941, the same date as the amendment to the Ruling, and provided:

> "Notwithstanding any other provision of law the tax imposed under this act shall apply to the gross receipts from the sale of *any* tangible personal property to contractors purchasing such property either as the agents of the United States or for their own account and subsequent resale to the United States for use in the performance of contracts with the United States for the construction of improvements on or to real property." (Emphasis added.)

Because the section provided that tax applies to the sale of *any* tangible personal property to contractors with the United States improving real property, it was necessary to provide in the ruling that such a contractor was the consumer not only of "materials," but of "fixtures" as well.

In 1943, effective July 11, the Retail Sales Tax Act of 1933 and the Use Tax Act of 1935 became part of the Revenue and Taxation Code, known and cited as the "Sales and Use Tax Law." Section 5.3 of the Retail Sales Tax Act became Section 6384 of the Sales and Use Tax Law, and, effective July 1, 1943, Ruling 12 was adopted, entitled "United States Contractors," based upon section 6384, and superseding the paragraph added to Ruling 11 in 1941 relating to United States Contractors.

As noted in the history of the law and rulings, section 6384 *requires* a different application of tax with respect to "fixtures" sold to United States contractors, as compared to "fixtures" sold to other contractors.

The case of *General Electric Company v. State Board of Equalization*, 111 Cal. App. 2d 180, 191-92 (1952) specifically points to section 6384 as necessitating such "duality of treatment," in the following clear, unambiguous language at page 192:

> "Rule 12 was made necessary by the specific provisions of the tax statute. Section 6381 of the Revenue and Taxation Code exempts from the sales tax gross receipts derived from the sale of tangible personal property to the United States. Section 6384 of that code, in order that the state shall collect some tax, requires that contractors shall be regarded as consumers. Unless they were so treated, contractors with the United States would pay no tax at all. This appears to be a reasonable basis for this classification between contractors."

The case of *Western Lithograph Co. v. State Bd. of Equalization*, 11 Cal. 2d 156 (1938) was decided in 1938, the year before section 6381 was enacted.

At the time the case was decided, the only tax exemption in the law for sales to the United States was provided in section 5 of the 1933 Retail Sales Tax Act which exempted, "the gross receipts from sales of tangible personal property which this state is prohibited from taxing *under the Constitution* or *laws of the United States of America,* or under the *Constitution* of this *State.*" The *Western Lithograph* case held that under the Constitution of the United States and the State of California, a sales tax is not an unconstitutional tax upon a federal instrumentality unless it is imposed directly upon that federal instrumentality. The California sales tax is imposed on the retailer. Only reimbursement is collected from the purchaser. We will cover this point exhaustively below in Argument III. The following year in 1939, the Legislature enacted section 5.1 of the Retail Sales Act of 1933, which provided:

> "There are hereby specifically exempted from the provisions of this act and from the computation of the amount of taxes levied, assessed or payable hereunder the gross receipts from the sale of any tangible personal property to the United States or any agency or instrumentality thereof except a corporate agency or corporate instrumentality."

This act was an urgency measure and was explained as necessary because,

> "Bids running into millions of dollars have been submitted by California firms to the Federal Government for contracts to supply necessary materials for Federal construction projects.
>
> "All these bids were submitted upon the assumption that the Retail Sales Act of 1933 was

inapplicable to receipts derived from sales to Federal instrumentalities. Recently however, the redefinition of the scope of state authority to tax Federal instrumentalities has made such receipts subject to that Act.

"Unless this Act goes into immediate effect, the firms which have submitted these bids will be compelled to withdraw them, bids submitted by firms in other States will be accepted instead, and the material well-being of the people of California will be definitely impaired and retarded."

This section, subsequently in 1941, became section 6381 of the Revenue and Taxation Code and obviously provides for an exemption from sales tax on a retailer when that retailer makes a sale to a federal instrumentality regardless of the lack of a constitutional exemption as decided in the *Western Lithograph* case.

Section 6381 has no application to a tax directly imposed upon a federal instrumentality. Such a tax would be prohibited by the United States Constitution as in the case of the use tax which is imposed on the consumer. Section 6381 is an exemption granted to *retailers* to the United States. It has no application whatsoever to sales or use *by* the United States. Furthermore, the exemption in terms is absolute, provided the purchaser is any of the purchasers enumerated in (a) or (b) of section 6381, without regard to whether the tax *on the retailer* constitutes a substantial interference with federal governmental functions.

Section 6384, upon which Regulation 1615 on United States contractors is based, *narrows* the scope of section 6381, by excluding from the state enacted exemption, sales of *any* property (including necessarily, "fix-

tures") to United States contractors. This has the effect of imposing tax upon sales of "fixtures" to United States contractors which would otherwise be exempt as sales for resale to the United States, the resale or sales to agents of the United States both being exempt under section 6381. This section, as above explained, did in fact enlarge the tax base by applying the tax to sales to United States contractors of certain property, including "fixtures," that would otherwise be exempt as sales for resale to the United States.

Regulation 1615 merely implements section 6384 which taxes the sale of *all* tangible personal property to contractors when used in government land improvement contracts. Without section 6384 and Regulation 1615, contractors can set up their contracts to resell to the United States or act as agents for the United States. In either case, section 6381 would have exempted the transaction.

Petitioner dwells at length upon the apparent inconsistency between the definition of "fixtures" in Regulations 1521 and 1615. While the terminology may appear inconsistent, it must be remembered that because of section 6384 there can be no different tax application between sales of "materials" and sales of "fixtures" to United States government contractors. The only distinction drawn by Regulation 1615 is between "fixtures" and "machinery and equipment," the latter being considered personal property sold by the contractor to the United States, under certain conditions. The term "fixtures" is defined in differing terminology in the two regulations, and hence does not have the same meaning in both regulations. The purpose of the definition of a "fixture" in Regulation 1521 is to distinguish "fix-

tures" from "materials" that is why "materials" are defined as being combined with each other, *integral* and *inseparable* parts of the completed structure, whereas "fixtures" are defined as accessories and which do not lose their identity as accessories when placed or installed. The distinction sought in these definitions is that between those portions of the building which have become incorporated and are inseparable from the completed structure and those portions which are clearly identifiable as accessories and removable after having been placed or installed.

The purpose of the definition of "fixtures" in Regulation 1615 is to distinguish "fixtures" which are taxable when purchased by a contractor because of their intended use as improvements to realty under section 6384 of the Revenue and Taxation Code from "machinery and equipment" which is not taxable in that such units are not a part of a structure on land. Consequently, fixtures are defined, " 'fixtures,' as distinguished from 'machinery and equipment,' are things which are necessary to a structure and so firmly attached to the realty as to constitute a part of the structure. They are essential to the use of the building or other structure.

It should be noticed that the word "inseparable" is left out of that definition. The purpose of the definition is merely to distinguish "fixtures" from "machinery and equipment" which are not a part of the structure nor accessory to the structure itself and which according to section 6384 of the Revenue and Taxation Code would not be taxable because they are not "improvements on or to real property to this State." It follows that there is no disparity between the two definitions because they have entirely different purposes. As noted above, the different tax treatment of "fixtures" in United States

government and non-United States government contracts is necessitated by section 6384.

Actually, the term "fixtures" as used in Regulation 1615 is inclusive of property that would fall within the definition of "materials" in Regulation 1521. This is perfectly consistent with the law, since section 6384 in effect wipes out the distinction between "materials" and "fixtures" insofar as sales to United States construction contractors is concerned. Petitioner's analysis of the law is erroneous and therefore its conclusion is without any legal foundation.

In summary then, it is the statutory policy of the State of California under section 6381 of the Revenue and Taxation Code to exempt from sales taxation, sales to the United States or its instrumentalities. Under this section, in the absence of any other statute, contractors for United States government improvements to real property would not pay any sales tax on "materials" or "fixtures" used in such construction because under the law they could be purchasing as agents for the United States or for resale to the United States and would be exempted from tax. They would not have to pay sales tax reimbursement or use tax as the "materials" and "fixtures" would be purchased for resale. Inasmuch as the resale would be to the United States government, it would be tax exempted under section 6381 of the Revenue and Taxation Code. It is for this reason that the Legislature, in order to impose a limit on this statutory exemption, enacted section 6384 to provide that contractors of the United States government make taxable purchases of the "materials" and "fixtures" which they use in the construction of improvement on or to real property in this state. Regulation 1615 is *required* by that statute. Therefore, Regula-

tion 1615 cannot be held to be discriminatory against United States contractors. The authority cited by Petitioner is no answer, particularly in light of *General Electric* which upheld the regulation of the State Board of Equalization under section 6384 of the Revenue and Taxation Code.

Contractors both for the state and its political subdivision and the federal government are taxed as consumers of "materials" which become an integral and inseparable part of the completed structure and consequently are assessed identical taxes.

The facts are that if a construction contractor, performing a construction contract for the improvement of real property in this state for the United States government purchased "materials" as defined in Regulation 1521 for such use, and the same contractor purchased identical materials for use in constructing a similar or identical building for a non-United States government customer, the tax would be imposed upon the same measure, provided that the cost to the contractor was the same. A sales tax would be imposed on the retailer selling to the contractor in both instances.

Under section 6006 and Regulation 1521 all but United States contractors are retailers of "fixtures." This law in fact, imposes a greater tax on the non-government contractor than a government contractor would bear in some cases because the government contractor is never treated as a retailer of tangible personal property in United States government contracts. He only pays sales tax reimbursement on his cost of purchase.

The case in which the tax is greater on the private contractor is where a manufacturer of fixtures is also the installing contractor. Petitioner did not manufacture any of the fixtures in this case and has no standing to complain. This is true because the manufacturing contractor must pay sales tax on the cost of the labor and overhead involved in the fabrication of this fixture. A government contractor would not have to pay such tax but would be deemed a consumer of the materials used in the manufacture of the fixture. It would appear that Petitioner's argument fails because of its reliance on *Moses Lakes Homes v. Grant County,* 365 U.S. 744, 751 (1961), where it is stated:

> "If anything is settled in the law, it is that a State may not discriminate *against* the Federal Government or its lessees." (Emphasis added).

In the Board's administration of the Sales and Use Tax Law the United States government construction contractor is certainly not discriminated *against* insofar as measure of tax is concerned. In fact, in the usual case, the United States government contractor pays less tax with respect to a similar construction job for the improvement to real property because he is a consumer of fixtures rather than the retailer of them.

One final point. It is utter nonsense to argue that the State of California enjoys a tax advantage over the United States in California state construction by virtue of the Sales Tax revenues it receives (Petition p. 13). Clearly, the tax burden paid by one agency of government is not offset by general fund revenue. The

argument demonstrates the length to which petitioner has gone to foist phoney issues upon this Honorable Court.

III

Revenue and Taxation Code Section 6384 Does Not Violate the Sovereign Authority of the United States Because the California Sales Tax Is Imposed on the Retailer so That the Federal Government Does Not Bear the Incidence of the Tax Assessed Under Section 6384

Petitioner challenges the validity of the sales tax imposed by the board on suppliers of government contractors as unconstitutional. In essence, Petitioner maintains that the legal incidence of the sales tax is on the purchaser as opposed to the retailer and that therefore the board has taxed the United States, exempt from such taxation under the provisions of section 548 of Title 12 of the United States Code in effect during the period here in controversy.

This contention is not a new one. Nearly 40 years ago this issue was litigated in *Western Lithograph Co. v. State Bd. of Equalization, supra,* 11 Cal. 2d 156 (1938). The California Supreme Court there held that the California sales tax was a tax on the retailer and as such was properly imposed upon retailers selling tangible personal property to national banks. 11 Cal. 2d 156 at 164. Even before the decision in the *Western Lithograph* case was handed down in 1938, California appellate courts and administrative agencies had uniformly held and still hold today that the California sales tax is a tax on the retailer and not the purchaser.

Indeed, in *National Ice, Etc. Co. v. Pacific F. Exp. Co.*, 11 Cal. 2d 283, 293 (1938), and again in *Ainsworth v. Bryant*, 34 Cal. 2d 465, 474 (1949), the California Supreme Court held that the retailer was under no obligation to reimburse himself from his customers and that his election to do so or not was merely optional. These holdings are in direct contradiction to Petitioner's contention that somehow the legal incidence of the California sales tax is on the purchaser.

In seeking to overturn these holdings, respondent relies upon *First Agricultural Bank of Berkshire County v. State Tax Commission*, 392 U.S. 339 (1968).

In the *Berkshire* case, this Honorable Court expressly recognized that a tax whose legal incidence was on the vendor could validly apply to sales to national banks. 392 U.S. 339 at 346, 347. The Massachusetts Supreme Court in the *Berkshire* case had labeled the Massachusetts sales tax as a "hybrid tax," which, unlike the California sales tax, the retailer was required to collect from the purchaser. *First Agricultural Bank v. State Tax Commission*, 229 N.E. 2d 245 (1967). This Honorable Court concluded that such hybrid type taxes which the retailer was required to add to the selling price collected from the purchaser could not be applied to sales to national banks under the provisions of section 548 of Title 12 of the United States Code.

Although the California sales tax has been consistently recognized as a vendor type tax (*i.e.*, a tax on the retailer only) by the appellate courts of this state as well as by state and federal agencies for almost 40 years, respondent now asserts that as a matter of federal law it is a tax on the purchaser. It will be demonstrated herein that Petitioner's contentions in this regard are unsupportable.

1. The California Appellate Decisions Have Consistently Held That the Legal Incidence of the California Sales Tax Is on the Retailer and Insofar as the Purchaser Is Concerned Is Merely Part of the Purchase Price

It is clear under the holdings of the California appellate cases that Petitioner's suppliers bore the legal incidence of the California sales tax and that its application to their gross receipts from sales to Petitioner was valid. There is no evidence that Petitioner was an agent for the United States in any event. Petitioner, in fact, claimed that the electric transmission lines were tangible personal property sold to the United States. No longer do they so contend inasmuch as electrical distribution lines are structures on land under *King*. Petitioner was taxed use tax on tangible personal property acquired ex-tax or on resale certificates. Therefore, even were Petitioner's contentions correct, the tax fell *not* on the United States but on Petitioner and was constitutional even under the contention that the California sales tax is on the purchaser, which of course, it is not. *Alabama v. King & Boozer*, 314 U.S. 1 (1941).

As noted earlier in this brief, this very issue of the validity of applying the California sales tax to gross receipts from sales to national banks has already been litigated in *Western Lithograph Co. v. State Bd. of Equalization, supra*, 11 Cal. 2d 156. The *Western Lithograph* case involved the sale of merchandise to a national banking association, Bank of America, on which Western Lithograph had paid sales tax measured by gross recepts from such sales. It was there argued by the plaintiff that the collection of sales tax reimbursement from the bank was violative of section 548 of Title 12 of the United States Code, which was

identical in terms with the provision of that section during the period involved in this litigation.[2]

In rejecting arguments basically similar to those advanced by Petitioner in the instant case, the California Supreme Court in the *Western Lithograph* case said:

> "The provisions of the act itself specifically are that the tax is laid upon and is a direct obligation of the retailer. Although the act furnishes the method by which the retailer may calculate reimbursement to himself by listing separately the amount of the tax from the sales price, *nevertheless section 8½ and other provisions of the act specially negative any intent of the legislature that the tax should be considered as a tax on the consumer.* In every case in which that question has arisen under the California Retail Sales Tax Act, the courts have uniformly and consistently recognized the legislative intent and adhered to the construction that the tax is upon the retailer and not upon the consumer. [Citations.]" (Emphasis added). 11 Cal. 2d 156 at 162.

The court then went on to point out:

> "The law contemplates the imposition of the fixed rate of the tax on the gross receipts, as defined by the act, and not on the individual sale of merchandise; and the provision for a bookkeeping method to compute the amount of the tax separately from the sales price does not alter this fact (Roth Drug, Inc., v. Johnson, supra, p. 738.)

[2] Section 548 of Title 12 of the United States Code was amended in 1969 to end restrictions on the power of the states to apply any form of sales or use tax to national banks located within the taxing state.

'That in ultimate effect the fund out of which payment [of the tax] is made may be or in fact has been obtained by the dealer from his customers does not make the tax a levy upon the consumer.' (People v. Herbert's of Los Angeles, Inc., supra.)

"*As noted in Meyer Construction Co. v. Corbett, supra, the act creates the relationship of sovereign power and taxpayer between the state and the retailer, and not between the state and the consumer.* Therefore when the question has been whether the tax is collectible on receipts from sales to municipalities within the state for use in governmental functions it has been held that the retailer must pay the tax. (Rio Grande Oil Co. v. Los Angeles, supra; Graham Brothers v. Los Angeles, supra)." (Emphasis added). 11 Cal. 2d 156 at 163.

The court, after pointing out that the purpose of separately stating the amount of sales tax reimbursement was designed to avoid including the amount of sales tax reimbursement in the measure of the tax, went on to state:

". . . *The tax being a direct obligation of the retailer and, so far as the consumer is concerned, a part of the price paid for the goods and nothing else, it is neither in fact nor in effect laid upon the consumer. It does not become a tax on the sale nor because of the sale, but remains an excise tax for the privilege of conducting a retail business measured by the gross receipts from sales.*" (Emphasis added). 11 Cal. 2d 156 at 164.

The decision in the *Western Lithograph* case upholding the application of the California sales tax to

the gross receipts from sales to national banks has stood unchallenged until recently. Nor does the *Western Lithograph* case stand alone as establishing the construction by the California appellate courts of the California sales tax as a tax on the retailer and not on the purchaser. The California appellate courts have consistently held that as to the purchaser the amount added as sales tax reimbursement is only part of the purchase price. *De Aryan v. Akers*, 12 Cal. 2d 781, 786 (1939).

Petitioner nevertheless asserts that the government contractor is the taxpayer since section 6052 of the Revenue and Taxation Code provides "The tax hereby imposed shall be collected by the retailer from the consumer *insofar as it can be done.*" (Emphasis added). Petitioner also makes reference to section 6053 of the Revenue and Taxation Code which precludes a retailer from advertising that he will absorb the tax as supporting their position. Despite declarations of the California Supreme Court to the contrary, Petitioner insists that these provisions evidence legislative intent that the consumer pay the sales tax and, therefore, the California sales tax is really a tax on the consumer which was barred by the provisions of section 548 of Title 12 of the United States Code prior to its recent amendment in 1969.

As previously noted, Petitioner's construction of the California sales tax has been expressly rejected by the California Supreme Court. Thus, in *Ainsworth v. Bryant, supra*, 34 Cal. 2d 465 (1949), the California Supreme Court in reviewing the California cases relat-

ing to this matter laid emphasis on the optional nature of the sales tax reimbursement provided for in the California sales tax statute. In that regard the Court said:

> "Reverting now to consideration of the terms of the San Francisco ordinance, the question arises as to exactly what kind of a tax is thereby imposed. Whatever it is and by whatever name it may be called, the character of the tax 'must be ascertained by its incidents, and from the natural and legal effect of the language employed in the [legislative enactment].' (Ingels v. Riley, 5 Cal. 2d 154, 159 [53 P.2d 939, 103 A.L.R. 1].) As appears from the above quoted portions of the ordinance, the tax is exacted of the consumer upon each transaction of sale, thus affecting the 'freedom of purchase' within the city. (53 C.J.S. 448.) So classified, it falls under the generic heading of a sales tax (47 Am.Jr. 194), but it rests on a wholly different concept from that underlying an occupation tax imposed upon a merchant for the privilege of doing business and measured by the gross receipts from sales. Illustrative of this latter type is the California Retail Sales Tax Act (Stats. 1933, p. 2599; as amended), which 'specifically declares that the tax is imposed *on retail merchants*, and not on the consumers. Section 3 provides in that regard, "For the privilege of selling tangible personal property *at retail a tax is hereby imposed upon retailers.*" Section 8 of the act further provides that "The tax levied hereunder *shall be a direct obligation of the retailer.*" ' (Roth Drug, Inc. v. Johnson, 13 Cal.App. 2d 720, 736 [57 P.2d 1022].) In view of such explicit provi-

ions establishing that 'the tax [is] on the retailer and not on the consumer' (Meyer Const. Co. v. Corbett (Cal.), 7 F.Supp. 616, 618), the cases have consistently so construed the act in recognition of the legislative intent. (National Ice & Cold Storage Co. v. Pacific Fruit Express Co., 11 Cal. 2d 283, 289 [79 P.2d 380], and cases cited; see, also, Western Lithograph Co. v. State Board of Equalization, 11 Cal.2d 156, 162 [78 P.2d 731, 117 A.L.R. 838]; De Aryan v. Akers, 12 Cal. 2d 781, 783 [87 P.2d 695].) While the act authorizes the retailer to collect the tax *'from the consumer in so far as the same can be done' (§ 8½), that does not make it a consumer's tax. Rather under the cited section, it is 'merely optional with the retail merchant as to whether he will reimburse himself from his customers for the tax he is compelled to pay'* (emphasis added; Roth Drug, Inc., v. Johnson, supra 13 Cal.App.2d 720, 736) as his direct obligation to the state in order 'to be allowed to sell tangible personal property at retail.' (Meyer Const. Co. v. Corbett (Cal.) supra, 7 F.Supp. 616, 618.)" (Emphasis added). 34 Cal. 2d 465 at 473-74.

The California cases further establish that the retailer is not entitled to sales tax reimbursement under circumstances where provision for its payment is not included in the terms of the contract. *Pacific Coast Engineering Co. v. State of California,* 111 Cal. App. 2d 31 (1952); *Clary v. Basalt Rock Co.,* 99 Cal. App. 2d 458 (1950); *Livingston Rock & Gravel Co. v. DeSalvo,* 136 Cal. App. 2d 156 (1955). These cases further establish that, contrary to the contention of petitioner, sections

6052 and 6053 do not require the retailer to collect sales tax from the purchaser if he does not choose to do so.

2. The Long Continued Administrative Construction of the California Sales Tax by Both State and Federal Agencies Establishes That This Tax Is Imposed on the Retailer and Not on the Purchaser

The state taxing authorities as well as the California appellate courts have consistently construed the sales tax as being imposed on the retailer who has the option to reimburse himself from the customer if he chooses to do so. This construction is evidenced by the litigated position taken in cases such as *Roth Drug Co. Inc. v. Johnson,* 13 Cal. App. 2d 720 (1936), where the court accepted the state's contention that sales tax reimbursement was merely optional with the retailer and he could waive his right to such reimbursement. 13 Cal. App. 2d 720, 736. To the same effect see Attorney General Opinion NS 103 rendered on December 23, 1936, wherein it was concluded that the retailer is permitted to pass on the sales tax but is not required to do so. The opinions of the Attorney General are of public record and the lapse of time since the first announcement of the opinion supports the inference that if it were contrary to legislative intent, some corrective measure would have been adopted. *See People v. Union Oil Co.,* 268 Cal. App. 2d 566, 571 (1968). The position that the legal incidence of the tax is on the retailer was also successfully taken by the Board in the *Western Lithograph* case discussed above and has been consistently followed since that time. Both before and after the decision in the *Berkshire* case the Board of Equalization has consistently taken the position that

since the legal incidence of the sales tax is on the retailer, it may be validly applied to the gross receipts from sales to government contractors. Contemporaneous administrative construction by the Board, while not necessarily controlling, "is entitled to great weight and the courts generally will not depart from such construction unless it is clearly erroneous or unauthorized." *Select Base Materials v. Board of Equalization*, 51 Cal. 2d 640, 647 (1959), quoting from *Coca-Cola Co. v. State Board of Equalization*, 25 Cal. 2d 918, 921 (1945).

Moreover, federal governmental agencies for thirty-five years have recognized that the legal incidence of the California sales tax is on the retailer rather than the consumer.

Various agencies of the federal government have concurred in the proposition that the California sales tax is a vendor type tax and that the legal incidence of the California sales tax is on the retailer rather than the consumer. Shortly after the passage of the California Retail Sales Act of 1933, the Internal Revenue Service ruled in Revenue Ruling XII-47 6518 IT 2733 that the legal incidence of the California sales tax was on the vendor so that the retailer alone could deduct the tax for federal income tax purposes. A copy of this Ruling is attached as Appendix 1 hereto.[3] Then in Decisions of the Controller A 88689 promulgated on January 31, 1942 (a copy of which is attached to this brief as Appendix 2), the United States Controller

[3]This ruling was handed down prior to the enactment of section 122 of the Revenue Act of 1942 which expressly made sales taxes imposed on the retailer deductible by the consumer. At this earlier time, consumers could not claim such a deduction if, as in California, the tax was imposed upon and paid by the retailer and not the consumer.

General clearly recognized that the California sales tax was on the retailer with the result that it was applicable to items purchased as necessary for the proper administration of the unemployment compensation laws and could be included in grants for that purpose. Further, in 1968 the United States General Accounting Office adhered to this view as to the legal incidence of the California sales tax. A copy of the letter from the office of the General Counsel of the United States Accounting Office is attached hereto as Appendix 3.[4] In accord, *Meyer Const. Co. v. Corbett,* 7 F. Supp. 616 (N.D. Cal. 1934), apparently the only final federal court decision dealing with the legal incidence of the California sales tax.

3. The Berkshire Case Does Not Require a Change in the Long-Established California Rule That the California Sales Tax May Be Validly Applied to the Gross Receipts From Sales to Government Contractors

The holding of *First Agricultural Bank of Berkshire County v. State Tax Commission, supra,* 392 U.S. 339, does not require a change in the long-established judicial and administrative construction to the effect that the legal incidence of the California sales tax is on the retailer with the result that it may be validly applied to the gross receipts from sales to government contractors. While Petitioner asserts that the matter of the legal incidence of the tax is purely a matter of federal law, this Honorable Court has made clear that in deciding the nature and incidence of the tax it is necessary to consider how the tax in fact operates.

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[4]This document is attached as an exhibit to the stipulation of Facts in *United States v. State Board of Equalization,* Civil No. 72-2568-R, which is cited at page 7 of Respondent's Supplemental Brief.

Thus, the United States Supreme Court has held that in a matter involving federal rights, the meaning to be given to a state statute turns not on the characterization which the state has given the tax but on its operation and effect. *St. Louis S.W. Ry. Co. v. Arkansas*, 240 U.S. 227, 231 (1916). The thirty-eight years of California case law and administrative construction outlined above establish a pattern of operation which demonstrates that the purchaser has no obligation to pay the sales tax and that its legal incidence clearly falls on the vendor.

In the *Berkshire* case this Honorable Court based its holding of invalidity of the Massachusetts tax on the fact that under the Massachusetts statutes it was mandatory for the retailer to pass the tax on to the purchaser. In that regard it was said:

> "It would appear to be indisputable that a sales tax which by its terms must be passed on to the purchaser imposes the legal incidence of the tax upon the purchaser. See Federal Land Bank v. Bismarck Lumber Co., 314 U.S. 95, 99. Subsection 3 of the Massachuetts sales tax provides:
>
> " 'Reimbursement for the tax hereby imposed *shall be paid by the purchaser* to the vendor and each vendor in this commonwealth *shall add to the sales price and shall collect from the purchaser the full amount of the tax imposed by this section,* or an amount equal as nearly as possible or practicable to the average equivalent thereof; *and such tax shall be a debt from the purchaser to the vendor,* when so added to the sales price, and shall be recoverable at law in the same manner as other debts.' Acts and Resolves, 1966, c. 14, § 1, subsec. 3. (Emphasis added.)

"This subsection reads to us as a clear requirement that the sales tax be passed on to the purchaser. . . ." (Emphasis added). 392 U.S. at 347-48.

Unlike the so-called hybrid type sales tax of Massachusetts involved in the *Berkshire* case, there is in California no mandatory requirement that the California sales tax be passed on to the purchaser. Moreover, in construing whether reimbursement is mandatory or not, the state court construction is obviously controlled in establishing the way the statute operates in practice.

As indicated by the cases cited above, the California sales tax is clearly a vendor type tax which does not mandate any payment by the purchaser.

In discussing the sales taxes of the various states the leading authority on the subject, John F. Due, in his book State and Local Sales Taxation (1972), had this to say about the vendor type taxes:

"VENDOR TAXES

"Fourteen of the taxes are, at least by law, basically vendor levies. They are imposed on the legal basis of the 'privilege' of engaging in business as a retailer or of the closely related concept of the 'privilege' of selling at retail. This vendor-tax group consists of Arizona, California, Connecticut, Hawaii, Kentucky, Michigan, Nevada, New Mexico, North Dakota, South Carolina, South Dakota, Tennessee, Virginia and Wisconsin.

"None of these states requires shifting of the tax to the consumer. California, Connecticut, Nevada, and Tennessee require shifting 'insofar as possible,' a phrase having little significance except to make clear the legislative intent. Kentucky,

Michigan, North Dakota, South Carolina, South Dakota, and Virginia indicate that the tax 'may' be shifted. The laws in Arizona, Hawaii, New Mexico, and Wisconsin, the most strictly 'vendor' taxes of all, do not mention shifting."

Professor Due distinguished vendor type taxes from hybrid taxes of the type involved in the *Berkshire* case as follows:

"HYBRID TAXES

"In thirteen states, plus the District of Columbia, the sales taxes contain both vendor and consumer features. The courts determine the precise legal status and most are held to be vendor taxes. Taxes are imposed on the vendor for the privilege of carrying on business or selling at retail, but the laws contain mandatory shifting provision. In other words, the tax is legally imposed upon the vendor, but he is required to collect it from the consumer."

The Massachusetts sales tax is universally recognized as a "hybrid type" tax rather than a vendor type tax as exists in California. In contrast to the California sales tax statute, the Massachusetts statute contains a mandatory requirement that the sales tax shall be passed on to the purchaser (See subsection 3 of the Massachusetts Sales Tax Act quoted above in the statement from the decision in the *Berkshire* case). In addition, it is to be observed that the Massachusetts statute, which was enacted in 1966, was being judicially construed for the first time in the *Berkshire* case. Unlike the situation in California in which there has been 40 years of judicial and administrative construction demonstrating the practical operation of the California law, this Honorable Court could only look to the lan-

guage of the Massachusetts statute as a guide to its meaning and operation.

The Massachusetts Supreme Court in construing its statute in *First Agricultural Bank v. State Tax Commission*, 229 N.E. 2d 245 (1967) at 249, recognized that the Massachusetts type sales tax was to be distinguished from the California type sales tax. The Massachusetts Supreme Court in referring to the California case of *Western Lithograph v. State Board of Equalization, supra*, 11 Cal. 2d 156, pointed out that the California sales tax was a vendor type tax with the legal incidence on the retailer. The Massachusetts court went on to say:

> "Our act is neither a vendor tax nor a purchaser tax but a hybrid containing elements of both vendor and purchaser taxes. See Dane, The New Sales and Use Tax Law, 51 Mass. L.Q. 239, 246, 249 (229 N.E.2d 245 at 249)."

In the article by Dane referred to in 51 Mass. Law Quarterly 241 at 246, the course of discussing the Massachusetts sales tax the distinction is made between the vendor type tax such as exists in California in which tax reimbursement by the customer is optional rather than mandatory and that of Massachusetts which requires a shift of the tax to the consumer. In that regard, the article states:

> "Massachusetts, in common with a majority of the sales tax states, has a hybrid tax where the tax is treated as a levy on the vendor for the privilege of selling at retail. Thus, subsection 7(a) of section 1 provides that 'no person shall do business in this commonwealth as a vendor unless a registration . . . shall have been issued to him.

This registration may be revoked if the vendor fails to carry out the obligations imposed on him by the law. § 1(7)(c). *The vendor,* however, *is required to shift the burden of the tax onto the consumer and collect it from him,* in accordance with the bracket system. §§ 1(3) and (4)." (Emphasis added).

"Sales taxes in use in the various states at the present time fall into three general classes: vendor taxes, consumer taxes and hybrid taxes. In states imposing a vendor type of levy, the legal basis of the tax is the 'privilege' of engaging in business as a retailer or the privilege of selling at retail. Vendor type taxes do not require a mandatory shifting of the burden of the tax to the consumer although in some states it is provided that the burden be shifted 'in so far as possible' or that the burden 'may' be shifted. The measure of the tax in these cases is either gross receipts or gross proceeds from retail sales.

"In the consumer type of tax, the tax is imposed either upon the retail sale or upon the purchaser, and the measure of tax liability is the selling price. All states imposing a consumer type tax require the vendor to collect the tax from the consumer and remit it to the state. They invariably require that the tax be kept separate from the price of the article and prescribe a bracket system for collection of the tax."

Unlike the Massachusetts sales tax, as demonstrated in the cases discussed above, the California sales tax need not be passed on to the purchaser. In the *Berkshire* case it was recognized that the legal incidence of

the tax was a controlling factor in determining its validity as applied to sales to national banks. In this regard, it was said:

> ". . . The court below held, contrary to appellant's contention, that the Massachusetts sales tax is not imposed upon the bank as a purchaser, but is a tax upon vendors who sell tangible personal property to the bank. *Of course if this is true, the bank cannot object if a particular vendor decides to pass the burden of the tax on to it through an increased price. . . .*" 392 U.S. 339 at 346, 347 (Emphasis added).

This Honorable Court, however, concluded that because the hybrid type Massachusetts statute required the retailer to collect the sales tax from the purchaser, it was therefore violative of section 548 of Title 12 of the United States Code. As pointed out above, the California Supreme Court has expressly held that insofar as the vendor type California sales tax is concerned, there is no mandatory requirement that sales tax reimbursement be obtained from the purchaser.

This significant difference between the vendor type California tax and the hybrid Massachusetts tax was also recognized by Professor John Due, the leading authority in the sales tax field, at page 79 of his book, State and Local Sales Taxation, wherein he states:

> "SALES TO NATIONAL BANKS
>
> "States were limited in their powers to tax national banks by section 5219 of the national banking legislation. As far as sales and use taxes are concerned, the courts, in a series of decisions, held that the states could apply their sales taxes to sales to national banks if the taxes were of

vendor type, but not if they were of the vendee type. Some vendee-tax states, however, did collect tax on sales to national banks, and the banks did not contest the tax. When Massachusetts and New York imposed sales taxes in 1966, both sought to apply tax to sales to national banks, even though the latter state had a strictly vendee tax and the former had a hybrid tax with some vendee characteristics. The lower courts upheld the power of the states to apply the taxes, but the United States Supreme Court, in the case of the First Agricultural National Bank of Berkshire County overruled the lower court and held the bank to be exempt. The consequence was the enactment of federal legislation in 1969 ending restrictions on the power of the states to apply any form of sales and use tax to national banks. Most states proceeded to do so in the following year."

In *Georgia Pacific Corporation v. County of Mendocino,* 357 F. Supp. 380 at page 383, the court stated:

". . . In United States v. Boyd, 378 U.S. 39, 84 S.Ct. 1518, 12 L.Ed.2d 713 (1964) the Court summarized the rulings of its controlling earlier decision as follows:

" 'The Constitution immunizes the United States and its property from taxation by the States, M'Culloch v. Maryland, 4 Wheat. 316, 4 L.Ed. 57, but it does not forbid a tax whose legal incidence is upon a contractor doing business with the United States, even though the economic burden of the tax, by contract or otherwise, is ultimately borne by the United States. James v. Dravo Contracting Co., 302 U.S. 134, 58 S.Ct. 208, 82 L.Ed. 155; Graves v. New York, 306 U.S. 466,

59 S.Ct. 595, 83 L.Ed. 927; Alabama v. King & Boozer, 314 U.S. 1, 62 S.Ct. 43, 86 L.Ed. 3. Nor is it forbidden for a State to tax the beneficial use by a federal contractor of property owned by the United States, even though the tax is measured by the value of the Government's property, United States v. City of Detroit, 355 U.S. 466, 78 S.Ct. 474, 2 L.Ed.2d 424, and even though his contract is for goods or services for the United States. Curry v. United States, 314 U.S. 14, 62 S.Ct. 48, 86 L.Ed. 9; Esso Standard Oil Co. v. Evans, 345 U.S. 495, 73 S.Ct. 800, 97 L.Ed. 1174; United States v. Township of Muskegon, 355 U.S. 484, 78 S.Ct. 483, 2 L.Ed.2d 436. The use by the contractor for his own private ends—in connection with commercial activities carried on for profit—is a separate and distinct taxable activity.' 378 U.S. at 44, 84 S.Ct. at 1521."

In reading the cases, it is clear that the line is clearly drawn between the *Kern-Limerick v. Scurlock*, 347 U.S. 110 (1954), and *King & Boozer, supra.* The most recent citation of *King & Boozer* is in *City of Los Angeles, v. A.E.C. Los Angeles*, 33 Cal. App. 3d 933, at 940, where the court states:

"Thus the fact that a municipal tax is imposed in a fashion which permits its ultimate economic burden to be passed on to a higher governmentality unit does not invalidate it (see General Dynamic Corporation v. County of Los Angeles, 51 Cal.2d 59, 63 [330 Pac.2d 794]; Kaiser Co. v. Reid, supra, 30 Cal.2d 610; Alabama v. King and Boozer, 31 U.S. 1."

King & Boozer was also cited in *United States v. Mississippi Tax Commission*, 37 L.Ed.2d No. 1, in Justice Douglas' dissent. (The fact that it is cited in a dissent may not make it probative, but the fact is that it is still deemed a viable case.) Therein Justice Douglas stated at page 18: "At least since Alabama v. King and Boozer . . . state taxes have been upheld on those doing business with the Federal Government, even as respects cost-plus contracts where the terms of the contract forced their payment out of the federal treasury." Further reference to *King & Boozer* is made in the dissent with reference to an article in 38 North Dakota Law Review 26, entitled "Recent Developments in Sovereign Immunity of the Federal Government from State and Local Taxes," by Lt. Col. Robert O. Rollman, Hq. AFSC. In June of this year a three-judge U.S. District Court in the same *Mississippi Tax Commission* case held that the Mississippi liquor sales tax was on the seller and valid on a federal enclave despite the economic burden on the federal government. *United States v. Mississippi Tax Commission et al.*, U.S. District Court for the Southern District of Mississippi, June 12, 1974, 35 CCH State Tax Review No. 48 pages 3-4 (November 26, 1974).

In summation, it is the Board's position that its interpretations of sections 6384 and 6007.5 are that the sale to the government contractor is the retail sale, and not the sale by the contractor. Also, the line has to be clearly drawn between the use of the property by the contractor for use in the performance of contracts

with the United States for the construction of improvements on or to real property in this state (*King & Boozer* type situation) and contracts for the sale of tangible personal property ("machinery and equipment," as defined in Regulation 1615) and other tangible personal property (*Kern-Limerick*). None of the cases cited by Petitioner establish that *King & Boozer* is not the present law in this area.

IV

The Court of Appeal Did Not Apply the Buck Act and Did Not Err

The Court of Appeal below, on its own motion, felt compelled to deal with the federal enclave question as it was clear that the contracts in question were performed on federal territory within the state of California. The opinion merely takes note of the fact that section 105 of 4 USC permits a sales tax on retailers doing business with the federal government on its enclaves and that section 107 of 4 USC is inapplicable to a tax the legal incidence of which is on the retailers. Therefore, the Court of Appeal did not apply 4 USC section 105 but, in effect, found that the act prevented any application of territorial immunity in this case to the contracts in question. Petitioner has raised no substantial federal question as regards the Buck Act except as it relates to the legal incidence of sales tax which has already been treated under the previous points. Inasmuch as the Court of Appeal correctly followed the federal decisions on the point there is no need for a grant of the writ herein.

Conclusion

This concludes the response to the petition in the instant case. Respondent believes that when the record is examined relative to the matters in issue and the opinion of the California Court of Appeal considered, it will be concluded by this Honorable Court that no right guaranteed by the Constitution of the United States was violated, and that the judgment should stand. Accordingly, respondent submits the matter on the record heretofore presented to this Court, the opinion of the California Court of Appeal and the arguments set forth above, and requests that the relief asked by this Petitioner be denied.

Respectfully submitted,

EVELLE J. YOUNGER,
Attorney General,

By PHILIP C. GRIFFIN,
Deputy Attorney General,

Attorneys for Respondent.

APPENDIX "1."

Revenue Act of 1932.

The tax imposed under the provisions of the California retail sales tax act of 1933 is an excise tax imposed by the State on the vendor for the privilege of engaging in the business of making sales at retail. For Federal income tax purposes the tax is an allowable deduction as a tax under section 23(c) of the Revenue Act of 1932 to the vendor only, upon whom it is imposed and who is liable for its payment. Where the vendor collects the amount of the tax from the vendee he must include the amount so collected in his gross income. The amount equivalent to the tax paid by the purchaser constitutes additional cost to him of the article purchased.

Advice is required whether the California sales tax, imposed upon the vendor for the privilege of engaging in the business of making sales at retail, is an allowable deduction by the vendor or the vendee for Federal income tax purposes.

The law under which the tax is imposed is the "Retail sales tax act of 1933." Section 3 provides:

> Sec. 3. For the privilege of selling tangible personal property at retail a tax is hereby imposed upon retailers at the rate of 2½ per cent of the gross receipts of any such retailer from the sale of all tangible personal property sold at retail in this State on and after August 1, 1933, and to and including June 30, 1935; and at the rate of 2 per cent of the gross receipts of any such retailer from the sale of all tangible personal property sold at retail in this State on and after July 1, 1935. Such tax shall be paid at the time and in the manner hereinafter provided and shall be in addition to any and all other taxes.

Other provisions of the law, so far as pertinent to the discussion of the question presented, read as follows:

Sec. 2. The following words, terms and phrases when used in this act have the meanings ascribed to them in this section, except where the context clearly indicates a different meaning:

* * *

(f) "Gross receipts" means the total amount of the sale price of the retail sales of retailer, including any services that are a part of such sales, valued in money, whether received in money or otherwise, including all receipts, cash, credits and property of any kind or nature, and also any amount for which credit is allowed by the seller to the purchaser, without any deduction therefrom on account of the cost of the property sold, the cost of the materials used, labor or service cost, interest paid, losses or any other expense whatsoever; provided, however, that cash discounts allowed and taken on sales shall not be included, and "gross receipts" shall not include the sale price of property returned by customers when the full sale price thereof is refunded either in cash or by credit, nor shall "gross receipts" include the price received for labor or services used in installing, applying, remodeling or repairing the property sold.

For the purpose of this act the total amount of the sale price above mentioned shall be deemed to be the amount received exclusive of the tax hereby imposed; provided, that the retailers shall establish to the satisfaction of the board that the tax imposed hereunder had been added to the sale price and not absorbed by the retailer.

(g) "Board" means the State Board of Equalization.

* * *

Sec. 8. It shall be unlawful for any retailer to advertise or hold out or state to the public or to any customer, directly or indirectly, that the tax or any part thereof imposed by this act will be assumed or absorbed by the retailer or that it will not be added to the selling price of the property sold, or if added that it or any part thereof will be refunded. Any person violating any of the provisions of this section shall be guilty of a misdemeanor.

Sec. 8½. The tax hereby imposed shall be collected by the retailer from the consumer in so far as the same can be done. * * *

Sec. 9. The tax levied hereunder shall be a direct obligation of the retailer and shall be due and payable in quarterly installments on or before the 15th day of the month next succeeding each quarterly period * * *.

* * *

Sec. 12. Thirty days after the effective date of this act, it shall be unlawful for any person to engage in or transact business as a retailer within this State, unless a permit or permits shall have been issued to him as hereinafter prescribed. * * *

The tax imposed under the provisions of the California retail sales tax act of 1933 is an excise tax imposed by the State on the vendor for the privilege of engaging in the business of making sales at retail. For Federal income tax purposes the tax is an allowable deduction

as a tax under section 23(c) of the Revenue Act of 1932 to the vendor only, upon whom it is imposed and who is liable for its payment. Where the vendor collects the amount of the tax from the vendee he must include the amount so collected in his gross income. The amount equivalent to the tax paid by the purchaser constitutes additional cost to him of the article purchased.

In the case of a vendor whose books are kept on the accrual basis, the amount of the tax actually accrued during the period covered by his Federal income tax return may be deducted in determining his net income. Where the vendor's books are kept on the cash receipts and disbursements basis, only the amount of the tax actually paid during the period covered by his Federal income tax return may be deducted in determining his net income.

APPENDIX "2."

State Sales Taxes—Inclusion in Federal Aid Unemployment Compensation Administration Grants.

The Social Security Board is authorized to include in its grants under section 302(a) of the Social Security Act to the State of California for unemployment compensation administration an amount representing the California retail sales tax—the legal incidence of which is upon the vendor—which the department of employment or other agency of the State is required to pay in connection with the purchase of supplies and equipment the Board finds necessary for the proper administration of the unemployment compensation laws of that State. 17 Comp. Gen. 223, modified.

Comptroller General Warren to the Federal Security Administrator, January 31, 1942:

With reference to the decision of September 8, 1937, of this office to the Chairman, Social Security Board, 17 Comp. Gen. 223, wherein it was held that the Social Security Board is not authorized to include in its grants to States the amount of the State sales tax which the State agencies are required under State laws to pay in connection with the purchase of supplies and equipment the Board finds necessary for the proper administration of the State unemployment compensation laws, there has been received from Fred E. Stewart, a member of the State Board of Equalization of the State of California, a letter dated December 9, 1941, reading as follows:

> The Department of Employment of the State of California informed us that the Acting Comptroller General of the United States on September 8,

1937, advised the Social Security Board that it was not authorized to include in its grants to this State under the provisions of section 302 (a) of the Social Security Act "the amount of the State sales tax which the State agencies are required under State laws to pay in connection with the purchase of supplies and equipment the Board finds necessary for the proper administration of the State unemployment compensation laws." The reason given in the opinion is that "the appropriation of Federal funds" is not "available for that purpose."

One of the items in the budget which was presented to the Social Security Board by the Unemployment Reserves Commission of this State was "the amount of State sales tax paid in connection with the purchase of supplies and equipment necessary for the administration of the State unemployment compensation laws," and the Social Security Board requested your advice as to whether it was authorized to include in its grants to this State the amounts so itemized and described in the budget. The request, in our opinion, did not disclose the true nature and legal incidence of the California Retail Sales Tax Act.

The Social Security Board has withheld from its grants to the State the budgeted items described above. Vendors selling supplies and equipment to the State of California for use by the department of employment, a State agency, have, accordingly, been unable to collect the full amount of the selling price, which results in confusion and misunderstanding.

The nature of the California tax is set forth in section 3 of the California Retail Sales Tax Act, which provides:

"For the privilege of selling tangible personal property at retail a tax is hereby imposed upon retailers * * * at the rate of 3% of the gross receipts of any such retailer from the sale of all tangible personal property sold at retail in this State * * *."

The term "retailer" is defined by section 2, subdivision (e) of the act as:

"Every person engaged in the business of making sales at retail * * * of tangible personal property * * *."

The nature of the tax has been uniformly construed by not only the State, but the Federal courts, as a tax upon vendors for the privilege of engaging in business at retail, and its legal incidence has been determined to be upon the seller and not upon the purchaser.

In *Western Lithograph Co. v. State Board of Equalization*, 11 Cal. (2d) 156, 164, the California Supreme Court stated:

"The tax being a direct obligation of the retailer and so far as the consumer is concerned, a part of the price paid for the goods and nothing else, it is neither in fact nor in effect laid upon the consumer. It does not become a tax on the sale nor because of the sale, but remains an excise tax for the privilege of conducting a retail business measure by the gross receipts from sales."

In addition to the *Western Lithograph Co.*, case, *supra*, the following cases definitely place the legal incidence of the tax upon the seller:

Roth Drugs, Inc. v. Johnson, 13 Cal.App. (2d) 720.

Meyer Construction Company v. Corbett, 7 Fed. Supp. 616.

People v. Herbert's of Los Angeles, 3 Cal. App.(2d) 482.

Graham Brothers, Inc. v. City of Los Angeles, 6 Cal.App.(2d) 203.

National Ice & Cold Storage Co. v. Pacific Fruit Express Co., 11 Cal. (2d) 283.

DeAryan v. Akers, 12 Cal. (2d) 781, Certiorari denied by U. S. Supreme Court, Oct. 9, 1939, Mem. 308 U. S. 581.

In *Roth Drugs, Inc. v. Johnson, supra*, the Court stated at page 736:

"This act does not impose the tax on the consumer. The last-mentioned section (sec. 8½) merely authorizes the retail merchant to reimburse himself from the consumer insofar as it may be consistently done. He is not required to do so. He may waive that right. Section 8 of the act merely declares that it shall be unlawful for the retailer to advertise that he will assume and pay the tax or that he will not add it to the price of his merchandising upon sale thereof. In considering the entire act we are impelled to hold it is merely optional with the retail merchant as to whether he will reimburse himself from his customers for the tax he is compelled to pay. The act specifically declares that the tax is imposed on retail

merchants, and not on the consumers. Section 3 provides in that regard, for the privilege of selling tangible personal property at retail a tax is hereby imposed upon retailers.' Section 9 of the act further provides that 'The tax levied hereunder shall be a direct obligation of the retailer.' Section 12 of the act prohibits any retail merchants from maintaining his business without first procuring a permit therefor as provided by that measure."

The amount of the purchase price is a matter of contract between the seller and the purchaser, each being free to refrain from selling or buying, as the case may be, except on such terms as to him may seem proper. The seller in order to determine the selling price of the merchandise must as a matter of course consider the amount of property, income, franchise, excise, and similar taxes, which he is called upon to pay by local, State, or Federal Government. Any tax, the legal incidence of which is upon the seller, cannot be disregarded by him in determining the selling price.

On November 10, 1941, the Supreme Court of the United States in two cases, *The State of Alabama v. King and Boozer*, 62 Sup. Ct. 43, 86 L. Ed. (Adv. Op.) 1, and *John C. Curry v. United States*, 62 Sup. Ct. 48, 86 L. Ed. (Adv. Op.) 6, considered the application of the Alabama sales and use taxes in connection with purchases made by "cost-plus-a-fixed-fee" contractors with the Federal Government.

The Court in the *King and Boozer* case stated:

"The Government, rightly we think, disclaims any contention that the Constitution, unaided by

Congressional legislation, prohibits a tax exacted from the contractors merely because it is passed on economically, by the terms of the contract or otherwise, as a part of the construction cost to the Government. So far as such a nondiscriminatory State tax upon the contractor enters into the cost of the materials to the Government, that is but a normal incident of the organization within the same territory of two independent taxing sovereignties. The asserted right of the one to be free of taxation by the other does not spell immunity from paying the added costs, attributable to the taxation of those who furnish supplies to the Government and who have been granted no tax immunity. So far as a different view has prevailed, see *Panhandle Oil Co. v. Knox, supra; Graves v. Texas Co., supra,* we think it no longer tenable."

The Court in the *Curry* case in considering the economic effect upon the Government makes the following statement:

"For the reasons stated at length in our opinion in the *King and Boozer* case we think that the contractors, in purchasing and bringing the building material into the State and in appropriating it to their contract with the Government, were not agents or instrumentalities of the Government; and they are not relieved of the tax, to which they would otherwise be subject, by reason of the fact that they are Government contractors. If the State law lays the tax upon them rather than the individual with whom they enter into a cost-plus contract like the present one, then it affects the Government, like the individual, only as

the economic burden is shifted to it through operation of the contract. As pointed out in the opinion in the *King and Boozer* case, by concession of the Government and on authority, the Constitution, without implementation by Congressional legislation, does not prohibit a tax upon Government contractors because its burden is passed on economically by the terms of the contract or otherwise as a part of the construction cost to the Government."

In view of these recent decisions, we respectfully request that you give further consideration to this problem, and that you advise the Social Security Board that it may include in its grants to the State of California the entire amount which the department of employment is required to pay in connection with the purchase of supplies and equipment for the administration of the California Unemployment Reserves Act without the deduction of any amount which may improperly be designated as a tax, but which actually constitutes a part of the purchase price of supplies and equipment.

Section 302(a) of the Social Security Act, 49 Stat. 626, provides, in part—

> The Board shall from time to time certify to the Secretary of the Treasury for payment to each State which has an unemployment compensation law approved by the Board under title IX, such amounts as the Board determines to be necessary for the proper administration of such law during the fiscal year in which such payment is to be made. * * *

The decision of September 8, 1937, *supra*, apparently was predicated to a considerable extent upon the ruling of the Supreme Court of the United States in the case of *Panhandle Oil Co. v. Mississippi ex rel. Knox*, 277 U.S. 218, to the effect that the vendor of gasoline sold to the United States was exempt from the payment of an excise tax measured by the quantity of gasoline sold upon the theory that the tax fell upon the Government. However, a careful examination of the recent decision of the Supreme Court of the United States in the case of *State of Alabama v. King and Boozer*, 314 U.S. 1, 86 L.ed. (Adv. Ops.) 1, leaves little or no room for doubt that a vendor who sells supplies to the United States is not exempt from the payment of a State sales tax upon the transaction unless the legal incidence of the tax is upon the vendee. And the holding of the Supreme Court of California is that the legal incidence of the retail sales tax of that State is upon the vendor (*Western Lithograph Co. v. State Board of Equalization, et al.*, 11 Cal. (2d) 156), so that the tax is not to be regarded as being passed on, as such, to the purchaser. Cf. *Lash's Products Co. v. United States*, 278 U.S. 175.

Such being the case it would appear that the price paid by the department of employment or other agency of the State of California for such supplies or equipment purchased by it as are "necessary for the proper administration" of the State's unemployment compensation laws may not be viewed as including, as such, the tax imposed on vendors by the provisions of the California Retail Sales Tax Act of 1933, as amended, although the sale price of the supplies or equipment may have been increased by reason of the imposition of such tax on the vendor; and as it thus appears that the tax loses its

identity as such and is merged in the purchase price paid by the State agency, the theory that grants which may be made to the State to cover the additional expense would be diverted to the payment of a State tax seems no longer tenable. Cf. decision of August 2, 1940, to you.

Accordingly, in view of the foregoing, I have to advise that the Social Security Board is authorized to include in its grants to the State of California for the purpose set forth in section 302(a) of the Social Security Act the entire amount which the department of employment or other State agency is required to pay in connection with the purchase of supplies and equipment the Board finds necessary for the proper administration of the unemployment compensation laws of that State without the deduction of any amount on account of the additional expense incurred by reason of the tax imposed by the provisions of the California Retail Sales Tax Act of 1933, as amended.

APPENDIX "3."

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20549

April 5, 1968

The Hertz Corporation
660 Madison Avenue
New York, New York 10021

Attention: Mr. Arthur J. Krug, Tax Manager

Gentlemen:

Your letter of March 19, 1968, reports that many of the States and lesser jurisdictions imposing a sales or use tax define "sale" as including "rental or lease," and thus there is a sales or use tax on the rental of motor vehicles. You advise that all but three of those States (namely California, Idaho and South Carolina) exempt from such taxation the rental of a motor vehicle to the United States and its instrumentalities and agencies. Enclosed with your letter are copies of relevant excerpts of the statutes, rules and regulations of the three above-named States.

You state that on many occasions, certain governmental users have not been paying the applicable sales or use tax on the rentals of motor vehicles in the aforementioned jurisdictions. You report that when the rental invoice is sent to the governmental user, the tax is crossed out or otherwise ignored and the net amount only is remitted to Hertz and that repeated billings therefor, and other efforts to collect the tax, have been to no avail. You advise that since Hertz is a collecting tax agent for the taxing jurisdiction, it has been held liable for those uncollected, unpaid taxes.

You request that we review the law of those (three) jurisdictions and furnish you an expression of the Government's position on the taxability of such rentals. Specifically, you request that we furnish you an advisory letter or ruling in the matter and that we send a bulletin or directive to governmental users setting forth their responsibility for the payment of the sales or use tax on the rentals of motor vehicles in the three States.

Concerning the payment of State sales taxes generally, our Office has held that the question of whether the United States is required to pay for an item procured in a State at a price inclusive of the sales tax imposed by that State rests upon a determination of whether the incidence of the tax is on the vendor or on the vendee. Where the incidence of the tax is on the vendor, the United States has no right—apart from State law or State statutory regulations promulgated thereunder by State authorities—to purchase (or lease) items within the territorial jurisdiction of the State on a tax free basis. See *Alabama v. King and Boozer,* 314 U.S. 1; 24 Comp. Gen. 150; 32 Comp. Gen. 423; *id.* 577; 33 Comp. Gen. 453; and 41 Comp. Gen. 719. On the other hand where the incidence of the tax is on the vendee, the United States in purchasing or leasing items for official use is entitled under its constitutional prerogative to make purchases or lease free from State taxes and to recover any amount of such taxes which may have been paid by it.

An examination of the laws of California and South Carolina discloses that the legal incidence of the State sales tax in those States is on the vendor. Hence, the United States is not constitutionally immune from the economic burden of such State taxes if by contract or

otherwise it is liable to the vendor for the amount of the tax. While California law exempts from the computation of the amount of the sales tax the gross receipts from sales to the United States, this exemption does not extend to rentals payable under a lease of tangible personal property. We found no provision of South Carolina law exempting from the computation of the amount of the sales tax, gross receipts from sales or rentals to the United States. Thus, in effect, car rentals by the Government in California and South Carolina would be subject to the State sales tax in those States, unless the rental agreement provides otherwise.

As to the State of Idaho, the enclosures with your letter indicate that the legal incidence of the Idaho sales tax is on the consumer. Hence, sales to the Federal Government and its agencies are not subject to the Idaho sales tax.

Concerning the "use" tax in the three States mentioned, since the legal incidence of a use tax is on the user of the tangible personal property, the United States is constitutionally immune from such tax, or a payment in lieu thereof.

Concerning your request that governmental users in the three States be sent a bulletin or directive setting forth their responsibility for the payment of the sales or use tax on the rentals of motor vehicles, almost all Federal agencies receive bound volumes of the decisions of the Comptroller General. Included in the bound volumes are the decisions of the Comptroller General cited above (as well as others), concerning the application of State sales taxes to sales to the United States. Thus, we see no necessity for issuing a bulletin or directive in the matter. Moreover, if your claim for payment of a

State sales tax on the rental of a motor vehicle is denied by the Federal agency involved and you feel that such denial was erroneous you may submit the claim here for consideration. The claim together with a recitation of the facts and circumstances giving rise thereto and any supporting papers should be sent to:

Claims Division
U.S. General Accounting Office
Washington, D.C. 20548.

Very truly yours,

/s/ J. H. Coffey
Assistant General Counsel